



DEPARTMENT OF THE TREASURY

Qualified Financial Contracts Recordkeeping Related to Orderly Liquidation Authority

AGENCY: Department of the Treasury.

ACTION: Notice of exemption.

SUMMARY: The Secretary of the Treasury (the “Secretary”), as Chairperson of the Financial Stability Oversight Council, after consultation with the Federal Deposit Insurance Corporation (the “FDIC”), is issuing a determination regarding a request for an exemption from certain requirements of the rule implementing the qualified financial contracts (“QFC”) recordkeeping requirements of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act” or the “Act”).

DATES: The exemption granted is applicable [INSERT DATE OF PUBLICATION IN FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT: Daniel Harty, Director, Office of Capital Markets, (202) 622-0509; Peter Nickoloff, Financial Economist, Office of Capital Markets, (202) 622-1692; or Stephen T. Milligan, Deputy Assistant General Counsel (Banking & Finance), (202) 622-4051.

SUPPLEMENTARY INFORMATION:

Background

On October 31, 2016, the Secretary published a final rule pursuant to section 210(c)(8)(H) of the Dodd-Frank Act requiring certain financial companies to maintain records with respect to their QFC positions, counterparties, legal documentation, and collateral that would assist the FDIC as receiver in exercising its rights and fulfilling its obligations under Title II of the Act (the “rule”).¹

Section 148.3(c)(3) of the rule provides that one or more records entities may request an exemption from one or more of the requirements of the rule by writing to the Department of the Treasury (“Treasury”), the FDIC, and the applicable primary financial regulatory agency or agencies, if any.² The written request for an exemption must: (i) identify the records entity or records entities or the types of records entities to which the exemption would apply; (ii) specify the requirements from which the records

¹ 31 CFR part 148; 81 FR 75624 (Oct. 31, 2016).

² 31 CFR 148.3(c)(3). The term “records entity” is defined at 31 CFR 148.2(n).

entities would be exempt; (iii) provide details as to the size, risk, complexity, leverage, frequency and dollar amount of QFCs, and interconnectedness to the financial system of each records entity, to the extent appropriate, and any other relevant factors; and (iv) specify the reasons why granting the exemption will not impair or impede the FDIC's ability to exercise its rights or fulfill its statutory obligations under sections 210(c)(8), (9), and (10) of the Act.³

The rule provides that, upon receipt of a written recommendation from the FDIC, prepared in consultation with the primary financial regulatory agency or agencies for the applicable records entity or entities, that takes into consideration each of the factors referenced in section 210(c)(8)(H)(iv) of the Act⁴ and any other factors the FDIC considers appropriate, the Secretary may grant, in whole or in part, a conditional or unconditional exemption from compliance with one or more of the requirements of the rule to one or more records entities.⁵ The rule further provides that, in determining whether to grant an exemption, the Secretary will consider any factors deemed appropriate by the Secretary, including whether application of one or more requirements of the rule is not necessary to achieve the purpose of the rule.

Request for Exemption

On January 7, 2020, RBC US Group Holdings LLC ("RIHC") submitted, on behalf of its subsidiary City National Securities Inc. ("CNS"), a request for an exemption from the rule to the Treasury, the FDIC, and, as the primary financial regulatory agency for CNS, the Securities and Exchange Commission ("SEC"), which RIHC supplemented with information provided on March 18, 2020.⁶ RIHC requested an exemption for CNS from compliance with sections 148.3 and 148.4 of the rule for the current and any future QFC portfolio of CNS. Such an exemption would in effect cover all QFCs that CNS may enter into, without any limitation as to the type of QFC, the nature of the counterparty, or any other factor. The request stated that CNS's current and anticipated future QFC portfolio consists predominantly of client

³ 12 U.S.C. 5390(c)(8), (9), and (10).

⁴ *Id.* Sec. 5390(c)(8)(H)(iv).

⁵ 31 CFR 148.3(c)(4)(i).

⁶ RIHC is a U.S. intermediate holding company subsidiary of Royal Bank of Canada, and is a records entity under the rule. CNS is registered with the SEC as a broker-dealer under the Securities Exchange Act of 1934 and as an investment adviser under the Investment Advisers Act of 1940.

activity QFCs, meaning cash market transactions CNS enters into on behalf of its retail customers and that are executed on standardized terms. Without an exemption, RIHC stated that CNS's cost of recordkeeping would impose an undue burden relative to the characteristics of its QFC portfolio, and submitted that, in the event the FDIC was appointed receiver of CNS under Title II of the Act, the records that CNS already maintains under current law and regulatory requirements should be sufficient to permit the FDIC to exercise its rights and fulfill its statutory obligations pursuant to its resolution authority under the Act. Further, RIHC stated that all of CNS's clients are "customers" as defined under the Securities Investor Protection Act of 1970 ("SIPA"). As such, RIHC stated that granting the requested exemption would not impair or impede the FDIC from exercising its rights or fulfilling its responsibilities under the Act and would be consistent with exemptions Treasury previously granted with respect to Morgan Stanley Smith Barney LLC ("MSSB")⁷ as well as with respect to Wells Fargo Clearing Services, LLC ("WFCS") and Wells Fargo Advisors Financial Network, LLC ("FiNet," and together with WFCS, "WFCS-FiNet").⁸

In support of its request, RIHC submitted information pertaining to the QFCs to which CNS is a party. RIHC represented that CNS's QFC portfolio is relatively small, poses low risk, has little complexity, has low trading frequency, has no leverage, and entails limited interconnectedness with the financial system. The request stated that CNS's QFC portfolio consists primarily of three types of QFCs to which it is a party, each of which is analogous to a type of QFC covered by the previous exemptions with respect to MSSB and WFCS-FiNet. Specifically, CNS primarily engages in client brokerage agreements, cash market QFCs governed by the client brokerage agreements and entered into on behalf of retail customers, and a master clearing agreement with CNS's clearing firm, an unaffiliated broker-dealer. RIHC represented that the cash market QFCs offered by CNS are limited to standard cash products, including common and preferred stocks, municipal, corporate, and agency bonds, U.S. Treasuries, commercial paper, structured notes, brokered certificates of deposit, mutual funds, and options. The request stated that CNS does not offer as part of its brokerage investment options or otherwise make available to its brokerage clients the types of QFCs that would exclude its clients from meeting the SIPA

⁷ See 83 FR 66618 (Dec. 27, 2018).

⁸ See 85 FR 1 (Jan. 2, 2020).

definition of “customer,” namely, currency contracts, commodity or related contracts, futures contracts, or any warrants or rights to purchase or subscribe to such contracts. Similar to MSSB and WFCS-FiNet, CNS is not registered with the Commodity Futures Trading Commission (“CFTC”) as a swap dealer or futures commission merchant, thus restricting its ability to transact in certain types of QFCs. Finally, RIHC represented that CNS’s interconnectedness to the rest of the financial system is limited based on its relatively small size and, like MSSB and WFCS-FiNet, its focus on non-institutional clients.

Evaluation of the Exemption Request

In evaluating the exemption request, Treasury considered the representations made by RIHC with respect to CNS’s QFC portfolio in terms of its size, risk, and complexity; trading frequency and leverage; and interconnectedness to the financial system. Treasury also considered RIHC’s statement that granting an exemption to CNS from the recordkeeping requirements of the rule would not impair or impede the ability of the FDIC to exercise its rights or fulfill its statutory obligations under Title II of the Act. RIHC’s views in this regard centered on its representation that all of CNS’s clients are “customers” as that term is defined under SIPA, and an assertion of how such customers and their QFCs would be handled by the FDIC in the event of a Title II resolution of CNS.

As discussed more fully in the preamble to the final rule,⁹ as well as in the determinations of exemption Treasury provided to MSSB and WFCS-FiNet, if the FDIC is appointed receiver of a covered financial company that is a broker-dealer and the FDIC establishes a bridge financial company to assist with the resolution of that broker-dealer, the FDIC must, pursuant to section 210(a)(1)(O) of the Act,¹⁰ unless certain conditions are met,¹¹ transfer to the bridge financial company all “customer accounts” of the broker-dealer and all associated “customer name securities” and “customer property,” as those terms

⁹ See 81 FR at 75624-25.

¹⁰ 12 U.S.C. 5390(a)(1)(O).

¹¹ Section 210(a)(1)(O)(i) of the Act stipulates two conditions under which the FDIC is permitted not to transfer all such customer accounts, customer name securities, and customer property to the bridge financial company: (i) if the FDIC determines, after consulting with the Securities Investor Protection Corporation and the SEC, that such customer accounts, customer securities, and customer property are likely to be promptly transferred to another registered broker-dealer; or (ii) if the transfer would materially interfere with the ability of the FDIC to avoid or mitigate serious adverse effects on financial stability or economic conditions in the United States. If neither such condition is met, the FDIC must transfer to a bridge financial company any QFCs entered into by the broker-dealer with its clients who are customers under SIPA.

are defined by reference to SIPA.¹² Treasury further discussed that the requirements of section 210(a)(1)(O) of the Act in combination with the “all or none rule”¹³ mean that, if the FDIC were to transfer a customer account that held QFCs between a covered broker-dealer and its client, the FDIC would be required to transfer (i) all QFCs between the broker-dealer and the client and, if the client is a non-natural person, (ii) all QFCs between the broker-dealer and any affiliates of such client. In the case of either (i) or (ii), the transfer would include, due to the all or none rule, any QFCs of the type that would not make the client a customer under SIPA, such as an FX spot agreement.

However, RIHC stated that CNS does not engage in the types of QFCs that would exclude its clients from the SIPA definition of customer. RIHC stated that CNS offers its retail customers only standard cash products as described above. Further, as CNS is not registered with the CFTC as a swap dealer or futures commission merchant, its ability to transact in certain types of QFCs is restricted. As represented by RIHC, CNS’s QFCs with its retail customers are of a small size, present little complexity and leverage, have low trading frequency, and impose little risk.

Treasury received a final recommendation from the FDIC regarding the exemption request, prepared in consultation with the SEC, and, after consultation with the FDIC, Treasury is making the determinations discussed below.¹⁴

Determination of Exemption

¹² 15 U.S.C. 78aaa *et seq.* See also section 201(a)(10) of the Dodd-Frank Act (12 U.S.C. 5381(a)(10)) (providing that the terms “customer,” “customer name securities,” and “customer property” as used in Title II shall have the same meaning as provided in SIPA).

¹³ Under the “all or none rule” of the Act, if the FDIC determines to transfer, disaffirm or repudiate any QFC with a particular counterparty, it must transfer, disaffirm or repudiate (i) all QFCs between the covered financial company and such counterparty and (ii) all QFCs between the covered financial company and any affiliate of such counterparty. See, 12 U.S.C. 5390(c)(9)(A) and 5390(c)(11).

¹⁴ All exemptions to the recordkeeping requirements of the rule are made at the discretion of the Secretary and the Secretary’s discretion is not limited by any recommendations received from other governmental agencies. Exemptions to the FDIC’s recordkeeping rules under 12 CFR Part 371 (Recordkeeping Requirements for Qualified Financial Contracts) are at the discretion of the board of directors of the FDIC and entail a separate request, process, and policy considerations. References to the FDIC in this notice should not be taken to imply that the FDIC has determined that similar exemptions under Part 371 would be available.

Given the above-discussed restrictions on the FDIC's discretion as to whether or not to transfer QFCs¹⁵ from a broker-dealer, the limited nature of CNS's business, and the limited types of QFCs entered into by CNS with its clients, Treasury has determined to grant CNS an exemption from the recordkeeping requirements of the rule with respect to any QFCs of CNS with clients that are customers¹⁶ of CNS under SIPA with respect to any transactions or accounts they have with CNS, subject to the terms and conditions stipulated below. Treasury does not expect that granting this conditional exemption will unduly hinder the FDIC as receiver in exercising its rights and fulfilling its obligations under the Act or interfere with the FDIC's ability to avoid or mitigate serious adverse effects on financial stability or economic conditions in the United States. In CNS's case, the size, risk, complexity, and leverage of its QFCs with its customers do not present a high likelihood that the financial stability exception to the transfer requirement of section 210(a)(1)(O) of the Act would be met. If the financial stability exception is not met, the FDIC would likely either transfer, pursuant to section 210(a)(1)(O), all of a broker-dealer's customer accounts, customer name securities, and customer property included in such customer accounts and any other QFCs with such customer to the bridge financial company or transfer all such accounts, securities, and property to another broker-dealer. In either case, the FDIC would not need the detailed records required by the rule with respect to QFCs to accomplish the transfer.

For the avoidance of doubt, Treasury is not granting the exemption request as presented in the RIHC request letter. There, RIHC requested an exemption for CNS from compliance with the rule for the current and any future QFC portfolio of CNS; that is, RIHC did not limit the exemption request only to QFCs with SIPA customers. If granted as requested, such an exemption would allow CNS to avoid recordkeeping for any and all QFCs that it may enter into now or in the future, without any limitation as to the type of QFC, the nature of the counterparty, or any other factor, including QFCs for its own account with counterparties who may be other broker-dealers or who may not otherwise qualify as customers under SIPA. Treasury is granting a narrower, limited and conditional exemption that applies only to QFCs with CNS customers; except as described in the next paragraph, CNS's QFCs for its own account

¹⁵ As used in the remainder of this notice of exemption, the term "QFC" means a qualified financial contract as defined for purposes of Title II of the Act. *See*, 12 U.S.C. 5390(c)(8)(D).

¹⁶ As used in the remainder of this notice of exemption, the term "customer" means a person who is a customer as defined in SIPA with respect to any transaction or account it has with CNS.

or with non-customers, whether or not affiliated with CNS, are not covered by this exemption and remain subject to the recordkeeping requirements of the rule. Consistent with the determinations of exemption Treasury provided to MSSB and WFCS-FiNet, Treasury has determined not to provide an exemption with respect to CNS's QFCs for its own account or with non-customers because the FDIC would retain discretion as to whether to transfer or retain such QFCs and because the size and risks of such QFCs at the time could be such that the FDIC would need the records required by the rule to make a transfer determination.

Treasury is also granting an exemption for any QFC entered into by CNS as introducing broker with another broker-dealer as clearing broker and that relates to the clearing of any exempted QFCs with CNS customers as discussed above, subject to the terms and conditions stipulated below, and provided that CNS maintains documentation of any agreement between CNS and each such clearing broker. This exemption would cover QFCs, such as a master clearing agreement, between CNS and its clearing broker that relate to the clearing of any CNS customer QFCs. For purposes of this exemption, the term "clearing broker" means an SEC-registered broker-dealer that is a member of the Financial Industry Regulatory Authority (FINRA) and has authority to execute, settle, and clear transactions and carry accounts on a fully disclosed basis on behalf of CNS and CNS's customers pursuant to a master clearing agreement or similar agreement. If the FDIC were to transfer the customer QFCs to a bridge financial company or other financial institution, it would presumably also transfer any master clearing agreement or similar agreement entered into with a clearing broker that facilitates the clearance or settlement of such customer QFCs. Therefore, the records required by the rule regarding such QFCs with a clearing broker should not be needed by the FDIC to address the clearance of CNS's exempted customer QFCs.

Conditions of the Exemption

The exemption granted below is based on the factual representations made by RIHC on behalf of CNS to Treasury, the FDIC, and the SEC, in its submissions, including the factual representations regarding CNS's registration as a broker-dealer and investment adviser, the limitations on its business lines, the limitations on the types of clients it serves and the types of products and services it offers its clients, the frequency, size, and dollar amounts of QFCs with clients, the lack of complexity of the QFCs

it has with clients, the number of client accounts it maintains, and the description of its activities as introducing broker on behalf of its customers with its clearing brokers.

Treasury reserves the right to rescind or modify the exemption at any time. Further, Treasury intends to reassess the exemption in five years. At that time, Treasury, in consultation with the FDIC and the SEC, would evaluate any material changes in the nature of CNS's business as well as any relevant changes to market structure or applicable law or other relevant factors that might affect the reasons for granting the exemptions. Treasury may request an updated submission from CNS as to its business at that time. Treasury expects that it would provide notice to CNS prior to any modification or rescission of the exemption and that, in the event of a rescission or modification, Treasury would grant CNS a limited period of time in which to come into compliance with the applicable recordkeeping requirements of the rule.

TERMS AND CONDITIONS OF THE EXEMPTION

CNS is hereby granted an exemption from the requirements of 31 CFR 148.3 and 148.4 for (i) any QFC entered into by CNS with or on behalf of any customer of CNS that is booked and carried in accounts at CNS maintained for the benefit of such customer; and (ii) any QFC entered into by CNS with a clearing broker that relates to the clearing of any QFC referenced in clause (i), provided that CNS maintains documentation of any agreement between CNS and each such clearing broker. For purposes of the exemption, "customer" means a person who is a customer as defined in 15 U.S.C. 7811(2) with respect to any transactions or accounts it has with CNS, and "clearing broker" means an SEC-registered broker-dealer that is a member of FINRA and has authority to execute, settle, and clear transactions and carry accounts on a fully disclosed basis on behalf of CNS and CNS's customers pursuant to a master clearing agreement or similar agreement.

This exemption is subject to modification or revocation at any time the Secretary determines that such action is necessary or appropriate in order to assist the FDIC as receiver for a covered financial company in being able to exercise its rights and fulfill its obligations under sections 210(c)(8), (9), or (10) of the Act. The exemption extends only to CNS and to no other entities.

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Nandini Ajmani,
Deputy Assistant Secretary for Capital Markets

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